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said, may re-act to the disadvantage both of the debtor and of the creditor.

Moreover, it follows that the more rapid the payments, the greater must be the economic dislocation.

I think you will agree that there is nothing which is more disturbing to mankind than such alterations in economic conditions as result from changes of price levels and of wages and other costs of production. The world has experienced this to the full since the war, and it is safe to say that the difficulties which now present themselves in all directions are largely due to causes of economic origin.

After the Franco-Prussian War, changes in economic conditions were similarly threatening, but were largely offset by increased production and by

developments in organization which had an alleviating effect.

Today, although the future is unknown, we cannot count upon any factor of that kind presenting itself.

I think that I have said enough to show that some adjustment, some modification, must take place in regard to the amount of the War Debts and Reparation payments if the world is to escape from an impossible situation, and that it is in the interest of all that there should be no such low standard of living imposed upon any one population as will either give to it the power of undue competition or will force it into bankruptcy. I think that America is more concerned than any other country, because she alone is in the position of being solely a creditor so far as war debts are concerned.

## An Analysis of the International War Debt Situation

By R. C. LEFFINGWELL

New York City, formerly Assistant Secretary of the Treasury

**T**HERE is pretty general agreement that the rehabilitation of Europe depends upon four things:

1. Peace and disarmament.
2. Balanced budgets and honest money.
3. The removal of international trade barriers.
4. The settlement of international war debts, including reparations.

America has made her contribution to the first of these at the Washington Conference in the program for naval disarmament. That was the particular form of disarmament that touched America closely and she made her contribution where she had a definite interest and a definite part to play. Disarmament in Europe must be

preceded by the settlement of political problems in Europe, and from that settlement America has, rightly or wrongly, definitely and repeatedly declared her detachment.

The countries of continental Europe cannot well balance their budgets or stop printing irredeemable paper money until they have established peace, reduced their military establishments, obtained a settlement or postponement of international war debts and reduced or eliminated subsidies and doles.

The removal of trade barriers in Europe is also inextricably interwoven with political questions there. But America is setting Europe in this

respect the worst possible example by raising her own tariff wall. The American farmer seems to have adopted the amazing view that he will get a better price for agricultural products if a tariff is enacted which will make it more difficult for Europe to pay for them. Politicians who would be intellectually bankrupt without the doctrine of protection, on which they were brought up, decline to open their minds to world changes which make trade barriers a burden rather than a benefit to us, or to the protests of supposedly protected industries.

#### REPARATIONS

The problem of reparations is one primarily for Europe to determine. The victors, the European Allies, are in perplexity to know how to force Germany to pay without destroying their own economic life. They are determined Germany shall pay; but they are determined not to destroy the German market for their own goods. They are determined Germany shall pay; but they are determined not to receive payment in German goods for fear of destroying home industries, and not to receive payment in German labor for fear of unemployment at home. The truth of the matter seems to be that, when in the Treaty of Versailles the Allies rejected annexations as a fruitful source of future wars, and substituted indemnities, they jumped out of the frying pan into the fire. It may be, on the whole, less troublesome to annex a province, with its people and industries as a going concern, than to subject an empire to economic servitude for a generation or two. Germany's capacity to produce great exports is unquestioned, but her capacity to produce a great export *balance* is very dubious. I suspect that the severest critics of the Treaty of Versailles are too optimistic in their

estimates of what Germany can pay, and what the Allies can afford to receive from her; and that reparations must be reduced to a relatively trivial sum and some other method found to punish Germany.

It is idle to suppose that the rehabilitation of Europe can come by relieving Germany and driving France to desperation. There has been enough, too much, of a disposition to lecture France, both here and in Great Britain, and far too little disposition to help her. France is the great sufferer from the War, and her lamentable policies today may to some extent result from the attitude towards her of Great Britain and the United States—always admonishing her and never offering her a way out.

The problem of reparations is not unrelated to the problem of inter-allied indebtedness. The French are indisposed to be more reasonable and generous in remitting claims, which have the sanction of an international treaty, against the vanquished enemy, than they find the United States disposed to be in remitting claims against its victorious but suffering ally.

The problem of inter-allied indebtedness is a very difficult one, made more difficult by our national habit of calling everything black or white and insisting on a yes or no answer to every question. Americans tend to divide themselves into two groups—those who believe that all the debts of the Allies to the United States should be cancelled at once out of the whole cloth, without any ifs, ands or buts, and those—the larger number today if the action of Congress is any indication of public opinion—who are disposed to insist upon the payment of principal and interest in every instance and without the remission of a dollar.

## QUESTION OF CANCELLATION

The suggestion of cancellation outright was made by former Attorney General Wickersham here, and in Europe by Mr. Keynes in his world-famous book, two years ago. Arguments in support of it in this country have been presented by Professor Moulton and Mr. Bass in their book entitled, *America and the Balance Sheet of Europe*; by Professor Seligman in a paper entitled, "The State of our National Finances," in the *American Economic Review* for March, 1922; by Mr. Justice Clark in an address before the Cleveland Chamber of Commerce, February 9, 1922; and by many others. The whole subject is discussed exhaustively in Mr. Friedman's book on "International Finance and Its Reorganization." Mr. Vanderlip has made a suggestion that Europe's debts to us should be applied to constructive and reconstructive work in Europe—a suggestion which seems to be as much beside the mark as the suggestion of the politicians in Washington who would have Europe's debts to us applied to the payment of a soldiers' bonus. The money has been spent and blown up. The question is whether the debts can and should be collected. If they ever are collected no doubt many proposals, benign and selfish, will be made as to the use of the money, notwithstanding the fact that it is devoted by the terms of the Liberty Loan Acts to the retirement of Liberty Bonds.

Congress, by the Act approved February 9, 1922, took away from the Secretary of the Treasury the power granted by the Liberty Bond Acts to refund the demand obligations held by the Treasury, conferred it upon a commission of five members, including, to be sure, the Secretary of the Treasury as chairman, and forbade the

cancellation of any debts whatever. The commission so created is admirably constituted, but its hands are tied.

And there is a good deal to be said against cancellation as such. The solemn obligation of one sovereign state to another ought not lightly to be disregarded on either side. It is said to have been the British practice to finance European wars and ultimately to forgive the debts so created. Such a policy would seem to be a fruitful source of war. If the more belligerent and irresponsible of the continental nations are allowed to fall into the habit of having a war when they will without paying for it, it is not difficult to understand that wars will be frequent. But do the congressmen and senators, who solemnly pass laws and make speeches declaring that the Allies' debts to America shall be paid, known how they propose to make those laws and declarations effective? Certainly not. On the contrary most of them know very well that a considerable part of the ten billion dollars never will be paid, principal or interest.

Might it not be a better plan, then, to authorize the Debt Commission to investigate the situation, to hold conversations with the debtor nations with a view to ascertaining their present and probable future financial situation and their present and probable future ability to pay; to study the effect upon American agriculture, commerce and industry of this indebtedness and the effort to collect it, and to report to Congress. It seems so unutterably stupid to close one's eyes and ears to the facts and refuse to permit even discussion by our official representatives of the problems which everyone knows exist and must sooner or later be disposed of. It is childish to continue to assert that all the debts must be paid when everyone knows that

some of them can't and won't be. Why not get down to earth and talk it over? Why not find out what part of the debts can be paid and what can't? Why not study what advantages, economic or otherwise, might be obtained for America as part of a general composition of debts?

The maintenance of these debts, notwithstanding interest has not been paid upon them, constitutes a grave handicap to the economic recovery of the debtor nations. If the cancellation of bad debts, the scaling down of dubious debts and the forgiving even of some good debts could be used to produce advantages greater than any we can hope to receive by persisting in our present stubborn attitude, by all means let us find it out.

An analysis of these debts probably ought to be made from three principal points of view:

1. How the debts came to be created.
2. The ability of the debtor to pay.
3. The effect upon the creditor of receiving payment.

#### CREATION OF THE DEBTS

The debts were justly created. That the money which America provided should take the form of a loan was proper and right. Had America given the money away, instead of loaning it, she would have abandoned a system wisely initiated by Great Britain and France themselves and pursued by them throughout the War—a system absolutely essential to any reasonable and practical division of war burdens. This has been elaborated and fully explained from the English point of view by Mr. R. Trouton in the *Economic Journal* (the quarterly Journal of the Royal Economic Society) for March, 1921. Mr. Trouton strongly defends, with reasons ample and convincing, the system by which the debts were created, although his conclusion,

equally supported by strong and persuasive arguments, is that the debts should now be cancelled.

Much of the ten billion dollars was loaned after the declaration of war by America, when England and France, Italy and Belgium were holding the line in Europe, waiting for us to take our part. During the early months of the War the Allies were borrowing from us \$500,000,000 a month and asking for more. After the first six months, however, the Allies were no longer able to spend dollars in the United States to the extent of five hundred million a month or anything like it, because our own military effort was absorbing our industrial life. There is an element of the grotesque in the fact that the fewer men a country had on the firing line the more claims it was able to establish against its allies; yet that is what happened under the system of accounting adopted, and properly adopted, by the Allies during the War.

Some of the debts were incurred for the support of sterling and franc exchange and, to a minor extent, for the support of lira exchange. When Great Britain bought sterling in the United States from the proceeds of loans from the American government she of course became the owner of the sterling and was to that extent relieved of the necessity of floating domestic loans in England to meet her requirements there. On the other hand, the sterling purchased may have come on the market in response to British or inter-allied purchases for war purposes somewhere in the world's markets.

An impression has been created that the United States required Great Britain in some sense to guarantee or make herself responsible for loans to others of the Allies after the United States entered into the War. That impression is wholly erroneous. Great

Britain had, before the United States entered into the War, established the rule that each Ally should be responsible for the financing of inter-allied purchases within its own borders. The same rule was extended to the United States when it entered into the War. Under that simple and sound rule the United States financed the requirements of the Allies within its borders; Great Britain financed the requirements of the Allies within the British Isles and, to a great extent, within the British Empire (but not in India, where the United States financed all the Allies by shipments of silver for a considerable period); and as to expenditures in the neutral world, Great Britain and the United States shared the burden of finance in accordance with a formula agreed upon between them.

The theory of the rule is simple. The people of each belligerent country could and should respond, in taxes and subscriptions for domestic loans, to the financial demands of its government. The American government could raise all the dollars the Allies needed, the British government all the sterling, the French government all the francs and the Italian government all the lire. On the other hand, because of embargoes on exports of gold and control of foreign exchange, no government could provide finance outside its borders, except at the expense of grave depreciation of its currency in foreign exchange. It was a matter of course that, under the sound rule thus established by Great Britain before the United States entered the War and continued without question thereafter, Great Britain should continue to be a lender as well as a borrower on international account.

After the United States entered the War, in one case only, did Great Britain make advances for purchases by

any of the Allies in the United States—that of Russia—and in that case only to the extent of contracts entered into by Russia and guaranteed by Great Britain before the United States entered the War. The amount is not important.

Some of the loans made by the United States were made after the Armistice. Following is an analysis of the advances made by the United States Treasury, prepared with a view to showing the extent of the loans made by the Treasury to the Allies after the War was over (actually though not technically) on the basis of Treasury Daily Statements.

PROPORTION OF DEBTS INCURRED AFTER THE  
ARMISTICE

To and including November 11, 1918, Armistice Day . . .	\$7,076,714,750.00
Thereafter, to and including June 28, 1919, when the Treaty of Versailles was signed . . . . .	\$2,025,570,265.56
Total to signing of peace . . .	\$9,102,285,015.56
Thereafter to January 10, 1920, the effective date of the Treaty . . . . .	350,720,914.09
Total to January 10, 1920	\$9,453,005,929.65

My impression is that advances subsequent to January 10, 1920, have been about balanced by repayments and represent little, if any, actual cash outgo, but rather a readjustment of accounts between the United States and the several borrowing governments. The amount of obligations of foreign governments representing Treasury advances less repayments of principal, according to the Public Debt Statement of January 31, 1922, was \$9,434,346,829.24. These figures do not include foreign obligations received on account of sales of surplus war supplies and European relief.

What I have said makes no pretense to be an exhaustive analysis of how the

debts were created. It is intended to serve only as an illustration of the fact that they were created in divers ways and for divers purposes, all to be sure for the prosecution of the War and for the national security and defense. The diversity, however, is of considerable importance from the point of view of discussion as to cancellation. Some of us may feel under a moral obligation to cancel loans made to provide munitions for armies in the field, before America was able to make her own military effort; and yet feel under no similar obligation in respect to loans, equally necessary and proper, made after Armistice Day for the purchase of foodstuffs or surplus war supplies which were resold by the borrowing government. For shot and shell and other equipment, necessary for the military forces in war time, blown up, destroyed and wasted, the borrowing government has nothing to show except the graves of the killed and the shattered bodies of the wounded and the glorious memory of sacrifice and victory. Other loans were merely a necessary part of the mechanics of war finance, and the borrowing government has already realized in whole or in part by the resale of the property purchased from the proceeds of them.

#### ABILITY OF THE DEBTOR TO PAY

When we come to consider the ability of the debtor to pay, equal diversity appears. Great Britain can pay no doubt in the sense that she can meet the interest charges and ultimately sell her own or private securities in our markets to an amount sufficient to lift the principal of the debt; yet it may be questioned whether Great Britain can pay in full without such disruption of her internal and international economy as would be gravely injurious to her and to us.

France is quite right in her position

that her ability to pay largely depends upon her ability to collect from Germany. Unless France can make collections from Germany, which everyone is now engaged in telling her she can not and should not make, it is difficult to see how France can make any important payments to the Allies.

Italy's ability to pay stands in much the same position as that of France, except that Italy has less to hope for in the way of collections from her enemies.

As to Belgium, we are under a moral obligation to release her and accept Germany's obligation in lieu of hers, so far as concerns pre-Armistice advances. Sooner or later we are certain to recognize that moral obligation, which rests not merely upon the tentative arrangement entered into at the Peace Conference, but upon the impregnable foundation of little Belgium's great service and sacrifices for all of us. Belgium is a highly civilized, densely populated country and there is no reason to suppose that she can make important payments on account of her international war debts, incurred before the Armistice, independent of her collections from Germany.

The indebtedness of other governments than those which I have now mentioned is perhaps, roughly, half a billion dollars. Some of it is collectible.

#### EFFECT OF PAYMENT UPON THE CREDITOR

In considering the ability of the debtor to pay, and the effect upon the creditor receiving payment, it is necessary to recall the fact that international payments can be made only in goods, services, gold or evidences of indebtedness (including paper money), and that it is only to the extent that it is able to create an export balance, i. e. export more of these than it imports, that any Ally will be able to

effect payments of principal or interest upon its indebtedness to the United States.

The public international war debts do not represent wealth created, but wealth destroyed. In this respect they differ from private international debts created in the ordinary course of business. Before the War Great Britain, not as a nation but as a community, had become the creditor of the whole world by the slow process of private accumulation and investment abroad intelligently made for productive purposes. Great Britain thus enriched herself and enriched her debtors in the process. Debts were gradually created in the ordinary course of trade and business, and the economic life of both debtor and creditor had ample opportunity to adjust to them. Coincidentally, the newer regions of the earth built up export balances, favorable to themselves and adverse to Great Britain, largely for foodstuffs and raw materials, which trade balances Great Britain was able to meet by adding, to her exports of finished products, exports of services (marine, banking, insurance, etc.) and by collecting interest on her capital invested abroad. But the public international war debts were created by the War abruptly and at the same time America's trade balance against Europe was enormously increased by the same war.

The collection of the debts due from the Allies to the United States will tend to stimulate imports into the United States and discourage exports from the United States, thus reducing America's so-called favorable balance of trade, or even eliminating it and substituting an "adverse" balance. No doubt America and the world can adjust themselves to this process if they must. But the process means that America, underpopulated, with vast

territories unexploited and undeveloped, shall produce less than it consumes, and that Europe, overpopulated, and having already pretty nearly reached the maximum of her productivity, must produce more than she consumes. It would seem that the only way in which the world could ultimately adjust itself to so abnormal an arrangement would be by converting the farm into a city and the city into a farm—that the problem will find its solution by a shift of population to both Americas, to the British Colonies, and to other more sparsely settled regions of the earth. Very obviously such a solution of the problem must be accompanied by protracted distress throughout the world including the United States.

The collection of the public international debts of the Allies to the United States, principal or interest, would serve, then, to subsidize imports and penalize exports from the United States, to reduce prices and wages here and to exaggerate the existing depression and unemployment.

### CONCLUSION

These are some of the considerations which ought to be taken into account by a commission created by Congress with adequate power to consider the problem of inter-allied indebtedness—not with its hands tied and its eyes blindfolded. Such a commission would doubtless take into account, also, the question whether, if disposed on account of any of the considerations previously discussed, to consider making some concessions in respect of the indebtedness of the allied governments to the United States, it might not be able, in return for such concessions, to obtain definite advantages by imposing reasonable conditions. What is really needed is a general settlement involving peace and disarmament,



balanced budgets and honest money, the removal of trade barriers and the settlement of international debts. If America could use her claims against Europe to promote so happy a solution of Europe's problems she would render herself at the same time the greatest of all services. She would bring to an end

the period of world-wide calamity which began nearly eight years ago and has continued through years of disastrous war and years of equally disastrous peace. She would reopen her own mills and factories, return the unemployed to their jobs, and restore her farmers to prosperity.

## The Public Financial Burdens of the Principal Countries of the World

By L. R. GOTTLIEB

Lecturer in Finance, New York University

IN Table I on page 116, an attempt has been made to compare the public debt and debt charges of the leading fifty countries of the world, comprising 83 per cent of the world's total population. It will be found that nations other than participants have barely doubled their debt since 1914; in the war-ridden countries there has been an eight-fold increase. Inflation has been one of the primary factors in the growth of public debts; it has lessened the intrinsic purchasing power of the monetary unit. Continual inflation tends to lighten the burden of the debt, while deflation operates in the reverse manner. The former stimulates business, causes a restriction in consumption and reduces the output of luxuries, thus setting commodities free for the use of the state; the latter factor, on the other hand, enriches the speculator at the expense of the citizens of the state involved. As deflation succeeds inflation, the burden of the debt becomes *pari passu* heavier and heavier. This is the problem confronting the future.

Before the War, France had the largest per capita debt of all countries in the list, with the exception of

Honduras<sup>1</sup> and New Zealand.<sup>2</sup> Today, Austria stands first, followed closely by Hungary, Germany, France, Belgium and the United Kingdom. Territorial re-arrangements resulting from the peace treaties account for the material enhancement in the per capita debt of the first two countries in particular.

An interesting observation to be recorded is that debt charges do not always keep pace with the growth in nominal amount of debt. A great deal depends upon the methods pursued in financing the government's requirements. Paper money directly issued by the state, as in Italy and Russia, involves no interest charges; while currency issued indirectly by the state through the medium of banks of issue who discount treasury bills, as in the case of Germany, Austria, etc., or through banks that make a direct loan to the government, as in the case of France, constitutes a debt the interest requirements of which are compara-

<sup>1</sup> Cognizance being taken of back interest accumulating since 1873.

<sup>2</sup> Government ownership largely explains the heavy per capita debt.